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SUBJECT: VENEZUELA: EXTRA HEAVY CRUDE-BEST CHANCE FOR
IMMEDIATE GROWTH

REF: CARACAS 2594

Classified By: Economic Counselor Richard Sanders; for reasons 1.4 (b)
and (d)

SUMMARY

11. (C) The prospects for additional Venezuelan oil production in the short term come from the four projects that produce synthetic crude from Venezuela's abundant resources of extra heavy crude. We calculate that Venezuela's syncrude production could increase to as much as 634,000 b/d by the end of 2004. Interest in new projects is building and some local industry observers believe we may see up to \$10-12 billion in new projects signed in Venezuela in the next year, primarily representing new investments in extra heavy crude extraction. International oil companies are exploring new economic models to accommodate the higher royalty rate demanded by the GOV. End Summary.

12. (U) The most important developments affecting Venezuelan production levels in the short term are likely to occur in the four "Strategic Association" projects that convert the extra heavy crude of Venezuela's Orinoco heavy oil belt to lighter, sweeter synthetic crude, or syncrude. In 2003, we calculate that these projects produced about 415,000 b/d of syncrude.

HAMACA

13. (C) As reported reftel, the upgrader of the Hamaca project (ChevronTexaco/ConocoPhillips/PDVSA), the fourth and last of the Strategic Associations is due to come on line in September. ChevronTexaco President for Latin America Upstream Ali Moshiri confirmed to econoff August 16 that the mechanical completion of the facility occurred on August 12. He also said there will be crude moving through the upgrader on September 1. While it will take some time for the facility to reach full production levels, by the end of 2004 the Hamaca project should increase its current field production of extra heavy crude from 120,000 b/d to 190,000 b/d for a syncrude yield of 180,000 b/d.

CERRO NEGRO

14. (C) ExxonMobil de Venezuela President Mark Ward informed econoff in a July 22 conversation that he was hopeful that ExxonMobil would soon receive approval from the GOV to proceed with debottlenecking the Cerro Negro (ExxonMobil/PDVSA) project upgrader. This process, if started in early 2005 as Ward hopes, would yield a 20 percent increase in the through-put of the upgrader by the first quarter of 2006. Currently, the Cerro Negro field produces 120,000 b/d of extra heavy crude for 110,000 b/d of syncrude, so the debottlenecking would allow an increase of field production to approximately 145,000 b/d for a yield of 132,000 b/d of syncrude.

PETROZUATA

15. (C) In addition, ConocoPhillips announced to the press early this month that Petrozuata (ConocoPhillips/PDVSA) had processed nearly 150,000 b/d of extra heavy crude into approximately 140,000 b/d of syncrude in July. "The new level was achieved through operational and technological improvements which gave the Petrozuata upgrader a new sustainable plateau of 140,000 b/d," said the statement. ExxonMobil's Mark Ward, however, asserted to econoff that Petrozuata had "pulled a fast one," and expanded its production capacity without GOV approval. According to Ward, Petrozuata's production level should nominally be at 130,000 but is actually at 160,000 b/d.

16. (C) Ward told econoff that Petrozuata is now arguing with the GOV over the royalty rate to be paid on the additional extra heavy crude that would support the project's expanded production capacity. (Note: The royalty for the Petrozuata project - as with all the Strategic Associations - is currently one percent. This royalty holiday lasts for nine years or until the project has re-couped some multiple of its investment. The GOV is now pushing for at least a 20 percent royalty for any additional production from these projects. End Note) While ConocoPhillips has not confirmed Ward's comments, careful comments by a ConocoPhillips Government Relations officer in an August 12 conversation with econoff might seem to confirm his allegations. She said the Petrozuata upgrader had produced 150,000 b/d of syncrude in July but that this had simply been "a one-off," to test the maximum through-put of the facility. She added that Petrozuata's planned syncrude production level is still 124,000 b/d and that PDVSA is keeping them to that plan. This could indicate, however, that Petrozuata could ultimately increase its sustained production to 140,000-150,000 b/d of syncrude.

SINCOR

17. (C) Finally, Sincor, the Total/Statoil/PDVSA project, will shut in production in October for 48 days to conduct a major turnaround. The planned overhaul will reportedly increase the current 180,000 b/d syncrude capacity of the upgrader by 14,000 b/d. Thus, according to our calculations, Venezuela's syncrude capacity could grow to some 634,000 b/d by the end of 2004 with the possibility of a further small increase in early 2006 by ExxonMobil's Cerro Negro.

18. (SBU) In an interesting side note, a senior Schlumberger executive commented to econoff on August 12 that the first of the Strategic Association projects is now starting to fight decline in field production. He agreed that the fields are experiencing gas problems earlier than had been expected and added that one field has now started to have a problem with water encroachment, that will over time, he asserted, affect them all.

MORE EXTRA HEAVY CRUDE PRODUCTION

19. (C) As reported reftel, there has also been at least one proposal to the GOV for additional field production of extra heavy crude. ChevronTexaco Vice President for Latin American Upstream Ali Moshiri told econoff August 6 that he had proposed to the GOV that the Hamaca project expand its field production to provide PDVSA with an additional 100,000 b/d of extra heavy crude. In a subsequent conversation on August 16, Moshiri said the GOV has "philosophically" accepted the proposal but that an agreement must still be structured. He said there has been no decision about whether the additional crude would be sold as part of the Hamaca project or separately. He confirmed it would likely be sold by PDVSA as Merey (a medium crude oil blend). When econoff asked Moshiri if the other three Strategic Association projects might make similar proposals to the GOV, he responded that, to his knowledge, only the Hamaca field has the extra capacity to produce over upgrader capacity.

MORE SYNCRUDE PROJECTS ON THE WAY?

110. (C) While the companies in the existing projects are engaged in discussions with the GOV on debottlenecking or otherwise expanding their syncrude production, proposals for bigger projects that would take the syncrude farther up the value chain to finished products have been made to the GOV. ChevronTexaco's Ali Moshiri announced August 6 that the company had made a \$6 billion proposal to the GOV for a new project. According to his announcement, the project would include exploration and production, a new pipeline and an upgrader to produce 200,000-400,000 b/d of high-quality syncrude and products. Shell de Venezuela President Moreno

has now stated publicly that his company has also proposed a similar project to produce syncrude and products. The Vice Minister of Energy for Hydrocarbons acknowledged to econoff that Total has made a similar proposal.

NEW ECONOMIC MODEL?

111. (C) In an August 19 conversation with Moshiri, he confirmed that the ChevronTexaco proposal envisions multiple companies along the project value chain. Under this model,

PDVSA would hold 51 percent of the upstream portion of the project while ChevronTexaco would control the downstream assets. Moshiri clearly believes that the economics of such a structure could work despite the 2001 Hydrocarbons Law requirement that PDVSA have 51 percent or more ownership in any upstream development. Moshiri dismissed any concern about whether PDVSA could finance its 51 percent. Moshiri added that ChevronTexaco's project proposal includes the use of its steam flood technology for enhanced crude recovery. (Note: The four Strategic Association projects currently recover 7-10 percent of the extra heavy crude. While Moshiri first said he did not know what the recovery rate might increase to with the use of the ChevronTexaco technology, he then said perhaps 40-50 percent. Increasing the extra heavy crude recovery rate is an important goal for the GOV.)

12. (C) Finally, econoff raised with Moshiri the possibility of a new licensing round for blocks in the Orinoco heavy oil belt. Moshiri responded that these projects are too big and complicated to auction and that he would urge the GOV not to do so. Instead, he anticipated that the GOV would proceed with a selective process to drive the projects towards the majors in partnership with PDVSA and certain Venezuelan companies.

COMMENT

13. (C) With the August 15 referendum having settled Venezuela's future for at least the next two years (they hope), ChevronTexaco's Moshiri and other oil industry representatives want to get down to business with the GOV. Some local industry observers believe we may see up to \$10-12 billion in new projects signed in Venezuela in the next year, primarily representing new investments in extra heavy crude projects.
McFarland

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